



# Transaction Analysis: Gaining an Edge

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At fixed income desks around the world, the use of tools to help ensure best trade execution has evolved beyond meeting fiduciary duty to clients. Now, those who apply the analytics of ‘Best Ex’ and Transaction Cost Analysis can refine their trade process to gain insight on costs, asset allocation, and assess counterparties. And as investor pressure on margins grows, the ability to more precisely measure trading performance spells an edge.

## The genesis

Best Execution requires financial institutions to provide the most favorable order execution for investors in given market conditions. The concept of [Best Ex](#) has existed since at least the 1930s, and with regulators’ increasing focus on investor protection, now more than ever, institutions are required to demonstrate compliance.

MifID II is a recent iteration of Best Ex regulation, and while it is European, the global footprint of many institutions mean it has had global impact since its rollout in 2018. Yet many firms still have no systematic way to show they meet requirements. So how can compliance be demonstrated?

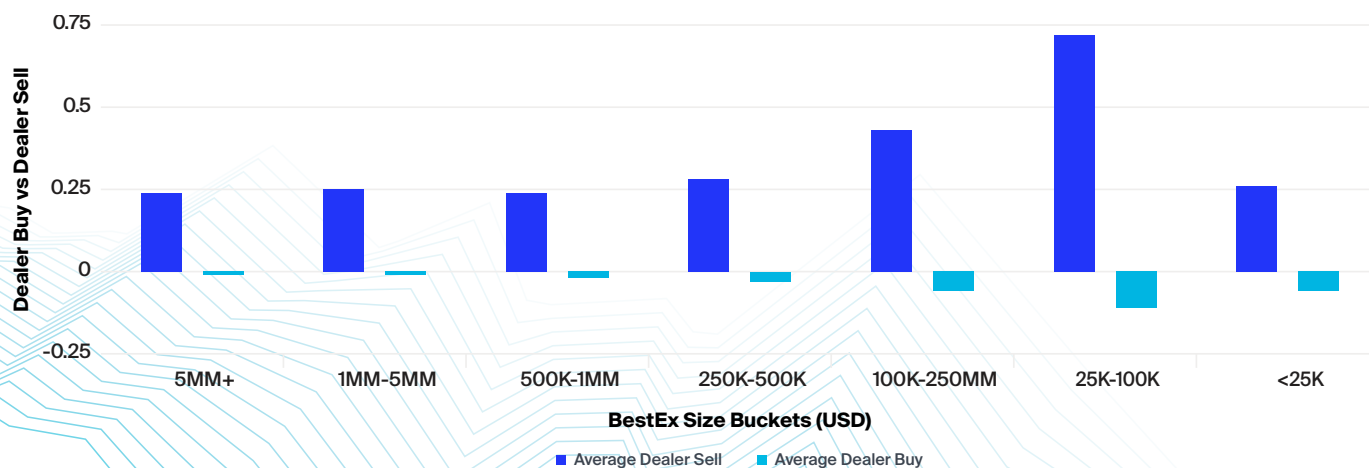
At ICE Data Services (IDS) Best Ex can help measure trade execution quality relative to comparable fixed income transactions in the market. The service covers U.S. investment grade, high yield, emerging market corporates, U.S. municipals; Europe, Middle East & African corporates, and Asia Pacific corporates and sovereigns.

When a bond is bought or sold, the transaction price can be compared to our Continuous Evaluated Pricing (CEP™) as a benchmark. The data fueling CEP is gathered from several sources: relationships with buy and sell side firms, arrangements with dealers and electronic trading platforms, and through public reporting systems operated by the Municipal Securities Rulemaking Board and Financial Industry Regulatory Authority.

To generate CEP, a rules-based pricing application is applied, overseen by a team of evaluators. This systematically captures and incorporates market information, and is designed to produce a pricing process that is responsive to market conditions. This continuous, independent evaluated pricing for fixed-income securities is a contrast to operators which provide limited coverage or only end-of-day pricing.

The ability to measure relative trading quality against a price benchmark is only one element of best execution. Over the past three years, best execution in the industry has evolved to include bond and trade-specific factors, such as trade intent, size, speed, likelihood of execution and more. As a result, large institutions which were early adopters have recognized the opportunity to more closely analyze their trades. Enter: Transaction Cost Analysis.

## Bid/Ask Spread (USIG - 10yr & 30yr) for TCA Analysis



## The evolution

Asset managers have traditionally lacked a robust set of tools to measure their trade costs comparatively - a contrast to the sell side, which have transparency on pricing and enjoy an information advantage. Although common and heavily used in equities, fixed income can now benefit from growing advancements in Best Ex and Transaction Cost Analysis (TCA). What was once a regulatory requirement has become an important set of metrics for traders, fund managers, and those who decide on asset allocation.

TCA provides a measurement of transaction costs, taking the liquidity of different instruments into account. For example, a trader may achieve Best Execution for both a high yield bond and Treasury debt - but their differing liquidity profiles mean they have very different transaction costs.

Importantly, TCA allows asset managers to monitor the elements of a trade in greater detail - for example: the cost to implement individual fixed income trading strategies by asset class and liquidity, how long a particular counterparty took to execute a transaction, whether they execute trades for a certain type of bond faster than others, and metrics which can be adjusted for regions and currencies.

**As a result, 'BestEx' committee meetings have become more frequent and influential within asset management firms, along with investment in 'Execution Analysts'. With the data to identify, monitor and adjust different trade factors, asset managers can more precisely tweak their strategy, for example – choosing certain venues or brokers. In short, the transparency offered by these tools enables asset managers to make more informed decisions.**

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Investor pressure on costs has also been a motivator for adoption. As best execution analysis becomes more widespread across fixed income, asset managers can proactively demonstrate to clients that they are reviewing trades to ensure value-add - or "Execution Alpha" for portfolios. Investors are actively seeking great transparency around execution costs, and asking more specific questions. In response, asset managers have taken steps to ensure they can respond to these new inquiries.

For the sell side, these tools represent the opportunity to win more business. By applying independent analysis to measure relative execution quality, they enable brokers to demonstrate their efficiency to asset managers and potentially gain more trade volume. TCA also allows dealers to gauge their performance relative to peers in a specific bond asset class, and further narrow this down by industry sector.

As the sophistication of Best Ex and TCA evolves, those who utilize these tools will be better positioned to analyze performance and hone their Best Ex strategy. And in a world of growing cost pressures, the ability to transparently demonstrate efficiencies to a range of stakeholders, will be more critical than ever.

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